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Annual Compliance Report, 2014	)))	Docket No. ACR2014

VALPAK DIRECT MARKETING SYSTEMS, INC. AND
VALPAK DEALERS' ASSOCIATION, INC.
REPLY COMMENTS ON THE UNITED STATES POSTAL SERVICE
FY 2014 ANNUAL COMPLIANCE REPORT
(February 13, 2015)

William J. Olson
Jeremiah L. Morgan
John S. Miles
WILLIAM J. OLSON, P.C.
370 Maple Avenue West, Suite 4
Vienna, Virginia 22180-5615
(703) 356-5070

Counsel for:
Valpak Direct Marketing Systems, Inc.
and Valpak Dealers' Association, Inc.

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Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association, Inc. ("Valpak") submitted Initial Comments on February 2, 2015, and submit the following Reply Comments with respect to the Initial Comments filed by certain other commenters.

COMMENTS

I. American Catalog Mailers Association

The arguments advanced by ACMA to justify the continuing subsidy that catalogers receive are no more persuasive than in prior Annual Compliance Reviews. Many have been previously addressed by Valpak. Some of these arguments have been expressly rejected by the Commission. And, with increased losses from Standard Flats, now totaling $3.5 billion, the arguments ring even more hollow than ever before.

A. ACMA's Commercial Members Profit Handsomely from the Postal Service's Largess through Subsidies Extracted from Other, Often Competing, Advertisers.

ACMA's Initial Comments state that an "ACMA unpublished Survey of Member Mail Use, 2012, showed 54%" of their "marketing budgets" are spent on postage. ACMA Initial Comments, p. 1, n.2. ACMA provides no information on that "survey" and the reader has no way to know what types of expenses are included, or excluded, in developing a catalog company's "marketing budget." From this vague description, one cannot tell if a typical catalog company spends 54 percent of its total budget, or 5 percent of its total budget, on postage. As such, it is a meaningless statistic.

However, some interesting information about ACMA members can be gleaned from ACMA's website. From there, we know that ACMA members are for-profit companies described as "Catalog Companies" and "Catalog Suppliers" which pay annual dues from

$1,000 to $30,000 per year.[1] In addition, ACMA solicits voluntary contributions from members and nonmembers for a variety of funds, including the "Postal Action Fund." ACMA makes the remarkable claim that:

> ACMA Members who joined early on in our history have generated **a 22x return on their dues investment in money saved on lower postage if not for ACMA's advocacy.** Yes, 22x — that's no typo.[2] [Emphasis added.]

This is a remarkable claim that deserves examination. Consider a cataloguer that joined ACMA last year with what ACMA terms an "Annual Catalog Postal Spend" of $10 million (or more) which is required to pay at the $30,000 "Annual Dues" level. Of that $10 million in postage, conservatively assume that it is entering two-thirds of its mail as Carrier Route and one-third[3] of its mail as Standard Flats — over 8 million Standard Flats. At the current level of subsidy, 9.1 cents per piece,[4] that **one commercial catalog company** received last year an **annual postal subsidy of $728,000 paid by its advertising competitors**. This 20-fold annual return is just about what ACMA claims! Over the seven-year period that Standard Flats losses

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[1] ACMA "Dues Structure," http://www.catalogmailers.org/clubportal/ClubStatic.cfm?clubID=2129&pubmenuoptID=36526.

[2] "ACMA Success," http://www.catalogmailers.org/clubportal/ClubStatic.cfm?clubID=2129& pubmenuoptID=36521.

[3] ACMA reports that cataloguers enter their mail as both Standard Flats and Carrier Route mail. ACMA Initial Comments, p. 2. In FY 2014, the volume of Standard Flats was 5.054395 billion, and the volume of Carrier Route was 8.980116 billion, for a total of about 14 billion primarily flats pieces, 36 percent of which is Standard Flats.

[4] Remember that the 9.1 cent unit loss is the amount needed just to cover attributable costs. If Standard Flats were required to pay its average attributable cost (49.4 cents) times the average Standard Mail coverage of 166 percent, Standard Flats prices would be required to increase to 82 cents.

have been able to be measured (FY 2008-FY 2014),[5] just one large commercial catalog company could have "earned" **$5 million in extra profit**. Yes, when the Postal Service is allowed to play favorites, efforts to "influence" postal pricing can be highly profitable, raising important questions:

Q. Where did the $728,000 in extra profit "earned" by one commercial catalog company in FY 2014 come from?
A. It came from other Standard Mail users, particularly mailers such as those that enter HD/Saturation Letters, that pay a cost coverage of 238 percent.

Q. How could the Postal Service have been allowed to set prices in this way?
A. Because the Postal Service has abused its pricing power over market dominant products that it enjoys due to its monopoly status — and the Postal Regulatory Commission, which Congress entrusted with the responsibility to ensure that prices are "fair" and "equitable," thus far has allowed it to occur.

Valpak, and other Standard Mailers, are tired of bearing the brunt of arbitrary Postal Service pricing decisions. They are tired of footing the bill for the costly underwater mail sent by other advertisers. The Commission simply must act in this docket by ordering effective remedial pricing.[6]

B. ACMA's Claim that Catalogs Are a Valued Source of Information Lacks Validity, but Certainly Does Not Justify Continuing the Subsidy to Some Commercial Catalogs.

ACMA's Initial Comments state:

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[5] *See* Valpak Initial Comments, p. III-2.

[6] To further illustrate the unfairness and inequity, in FY 2014, the attributable cost of **HD/Saturation Letters** was 6.2 cents. If HD/Saturation Letters paid the same average coverage of 82 percent as Standard Flats, the average rate would be **5 cents**, rather than **14.7 cents**, which it is now.

> catalogs have become a valued source of [information about] goods and services.... They ... serve as resource documents. [ACMA Initial Comments, p. 1.]

ACMA made a similar claim in Docket No. ACR2013. Docket No. ACR2013, ACMA Initial Comments, p. 1. Valpak responded to that claim at that time, and those comments are incorporated here by reference. Docket No. ACR2013, Valpak Reply Comments, pp. 2-4.

In addition, it is obvious that when catalogs are mailed, there are two possible outcomes:

> First, recipients may **discard** the catalog without being inspired to purchase anything (21 percent of persons find catalogs "not useful at all" or "not very useful"), indicating that the information contained in such catalogs would seem to have conveyed little value.[7]
>
> Second, recipients may be inspired by the catalogs to **purchase** something of value, indicating that there is value to senders (as well as recipients). In such circumstances, catalogers **profit**, sometimes handsomely, from such sales, and should be required to pay **at the very least** the **attributable cost** of whatever catalogs they chose to mail to generate those profitable sales.[8] There is no valid public policy reason

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[7] ACMA website, "Catalogs: The Consumers' Point of View," https://www.memberize.net/clubportal/clubdocs/2129/ACMA%20Consumer%20Survey%20Final%20release.pdf.

[8] In must be kept in mind that attributable costs account for less than 60 percent of the Postal Service's total costs. The Postal Service must recover the other 40+ percent of its total costs from coverage of commercial products.

that the advertising campaign of a commercial cataloguer should be **forcibly subsidized by other commercial advertisers** (*e.g.,* coupon mailers) with which they compete.

Indeed, a marketing study undertaken by ACMA demonstrates that 10 percent of respondents found **catalogs** "extremely useful" — a significantly smaller share than the 16 percent who found **coupon packages** to be "extremely useful." (Interestingly, the exact same percentage of persons — 46 percent — found both catalogs and coupon packages to be either "extremely useful" or "very useful."[9]) Based on this ACMA study, there certainly is no reason for coupon mailers to be forced to subsidize catalog mailers, even if such pricing were not barred by 39 U.S.C. § 101(d).

ACMA makes the dubious claim that a **distinguishing feature** of catalogs is serving some role as "resource documents." ACMA's claim that catalogs are somehow different (distinguished) from other sources of information would be news indeed to the millions of people who first turn to the Internet to access hundreds of thousands of electronically searchable "resource documents."

Undeniably, though, catalogs certainly have one **distinguishing feature** that ACMA omits to mention: namely, **catalogs are the only private commercial advertisers to receive a significant annual postal subsidy — which is extracted from other commercial advertisers — because of the arbitrary decisions of a government monopoly to charge below-cost prices**.

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9 ACMA website, "Catalogs: The Consumers' Point of View," https://www.memberize.net/clubportal/clubdocs/2129/ACMA%20Consumer%20Survey%20Final%20release.pdf.

All mail has value to someone, or it would not be sent. And regardless of whatever value catalogs may possess, ACMA's defense of the subsidy fails to acknowledge that **any price less than attributable cost necessarily sends mailers a wrong signal.** Below-cost pricing of the Standard Flats product simultaneously:

(I) harms the business of other commercial mailers who must pay more postage than would otherwise be required, and

(ii) undermines Postal Service finances, particularly in the long term.

Only when price at least equals the Postal Service's attributable cost can it be said that mailers are given proper economic signals. In no way can a below-cost price for a mature product like catalogs be considered correct.[10] Provided catalogers' decisions are based on economically correct prices, it appropriately is left to them to decide which catalogs may have value for certain consumers.[11] Such decisions obviously should not involve the Postal Service.

The Postal Service's job is to set the correct price for delivering catalogs and leave the rest to catalogers. In order to do its job right, though, the Postal Service needs to level the playing field and cease rewarding favored mailers with subsidized below-cost pricing. For too

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[10] In contrast to the Postal Service's blase indifference to sending the wrong price signals in Standard Flats, the Postal Service has made an effort to give mailers of flats destinating in FSS zones what it considers to be correct price differentials designed to encourage desired preparation in Docket No. R2015-4. *See* Response to ChIR No. 3, Q. 5. This contrast in the Postal Service's treatment of different Standard Flats products demonstrates just how inconsistent, politicized, arbitrary, and capricious the Postal Service's pricing decisions have become.

[11] Some companies publish multiple catalogs, *e.g.*, *see* Docket Nos. R2014-6 and MC2014-21, NSA with PHI Acquisitions, Inc.

many years, the Postal Service has been "investing"[12] in catalogs, via the annual losses which it incurs on Standard Flats. The Postal Service's pricing flexibility makes those dubious "investments" entirely avoidable, and the Postal Service would be far better off investing what might be termed "**contribution foregone**" (*i.e.*, losses) in, say, replacement of aging postal vehicles.[13] All such Postal Service investments to promote catalogs should cease forthwith. **It is time to get the Government out of the catalog business.**

In sum, whether any recipient considers catalogs a valued source of information is totally irrelevant to the correct price for delivering Standard Flats. ACMA's above-quoted statement concerning "value" and "resource documents" provides no support for continuation of below-cost, subsidized pricing to deliver catalogs. Catalogs should pay a price that at the very least covers their attributable cost, which would give mailers an appropriate economic signal. The Commission should call a halt to the Postal Service's love affair with catalogs and contempt for other users of Standard Mail, and level the playing field now.

Catalogers ought to, but apparently don't, feel embarrassed by the harm that they visit on their competitors and by the fact that Postal Service finances improve whenever the volume

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[12] Of course, if the Postal Service were actually investing its own money, it could be expected to be a better steward of those resources. It is only because of the postal monopoly that the Postal Service can compel mailers of market dominant products to pay rates far above what they would be in a competitive market. Because the Commission has been passive in the past, the statutory prohibition against unfair and inequitable and abusive pricing continues to be disregarded by the Postal Service.

[13] *See generally* A. Steele, "Postal Service Seeks to Retire the Old Mail Truck," Wall Street Journal (Feb. 12, 2015) ("The U.S. Postal Service [has taken] the first step in replacing the aging delivery-vehicle fleet, which is suffering from wear and tear and burdening an organization already strapped for resources….").

of Standard Flats declines. Indeed, ACMA's comments assiduously avoid any direct discussion of the 39 U.S.C. § 101(d) standards of "fairness" and "equity." For example, if the Postal Service decided to charge prices for Standard Flats that reflected a coverage of 238.0 percent — the coverage it imposes on HD/Saturation Letters — rather than a coverage of 81.6 percent which Standard Flats now pay, would ACMA consider that to be fair?

C. ACMA's Concern that Nonprofit Causes a Low Coverage in Standard Flats Is a Red Herring.

ACMA's Initial Comments endeavor to blame the low coverage of Standard Flats on the fact that Nonprofit Flats are included in the same **products** used by commercial catalogs:[14]

> Generally, catalogs are classified as flats. A minority is sent via Standard Flats (SF), a category that **includes a considerable amount of Nonprofit.** A majority is sent via Carrier Route (CR), another category that **includes Nonprofit,** as well as a few letters and parcels. A small share is sent via High-Density and Saturation Flats and Parcels (HD), which **also contains Nonprofit**. [ACMA Initial Comments, p. 2 (emphasis added).]

In addition to fingering Nonprofit as the villain which causes Standard Flats to have a coverage of only 81.6 percent, ACMA also persists in manipulating existing **rate categories**

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[14] ACMA's comments neglect to point out: (i) the law entitles qualified nonprofit organizations to use every category of Standard Mail (39 U.S.C. § 3626); and (ii) every category of Standard Mail does in fact have a Nonprofit component. Every other Standard Mail category contains at least 5 percent Nonprofit mail with the sole exception of Parcels, which contains only 0.6 percent Nonprofit mail. ACMA apparently would prefer that **commercial** catalogs just cover their attributable cost, while leaving Nonprofit Flats deeply underwater — to be subsidized by someone else. ACMA's grievances concerning inclusion of Nonprofit in Standard Mail products should be addressed to Congress — not the Commission. However, it is interesting how catalog mailers protest when they are required to subsidize what they view to be another product — Nonprofit Flats. They should consider how they would feel about being in the position of mailers of HD/Saturation Letters required to subside catalogs.

within Standard Mail **products** in ways designed to suit its own ends.[15] In Docket No. ACR2011, **the Commission determined this ACMA argument (previously referred to as a "burden test") to be bogus**. *See* FY 2011 ACD, pp. 117-118 ("measuring cost coverage is a reasonable way to test for intra-class cross-subsidies"). *See also* FY 2012 ACD, p. 116 ("While the Commission is mindful of the possible relationship between Flats and other products, there is insufficient information to identify with any reliability what types of mail can be deemed 'responsible' for other items in the mailstream."). However, ACMA persists.

ACMA starts by partitioning selected Standard Mail **products** that contain some amount of catalogs into a subset of categories described as "commercial" (*i.e.*, catalogs) and "Nonprofit." ACMA then seeks to divert attention from the issue of correct pricing for the "combined" underwater Standard Flats **product** by focusing on whether all *c*ommercial catalogs in Standard Mail, regardless of the **product** in which mailed, collectively cover their attributable cost. **"Commercial catalogs" is not, and never has been, a product within Standard Mail, and should not be viewed as one.** Mental exercises such as ACMA's are a desperate effort to maintain a subsidy worth $460 million, wholly irrelevant to the legal issue. Following are several reasons why ACMA's arguments should not deter the Commission from using this year's ACD to order a substantial increase in the price of Standard Flats.

First, within Standard Mail the law requires that nonprofit rates be lower than the commercial rate. Thus, coverage on the commercial portion within each separate **product** necessarily will be higher than coverage on the entire **product**. Within each

[15] *See* Docket No. ACR2013, Valpak Reply Comments, pp. 9-11.

product, the commercial and Nonprofit categories are "joined at the hip," so to speak. To illustrate, if it is determined that within the Standard Flats **product** the price of Nonprofit needs to be increased, which would appear to be the case, the one and only way to do so is to increase the price of the commercial category,[16] exactly as is the case within every other Standard Mail product (*see* below).

Second, although ACMA's Initial Comments correctly note that 22.6 percent of Standard **Flats** is Nonprofit, ACMA notably fails to mention that approximately 20 percent of Standard **Letters** is Nonprofit — *i.e.*, Standard Flats and Standard Letters have a roughly similar percentage of Nonprofit — yet the Standard Letters product has a combined (commercial and Nonprofit) coverage of 200.5 percent, **more than double** the 81.6 percent coverage of the Standard Flats product.

Third, ACMA also does not mention that over 14 percent of the HD/Saturation Letter product is Nonprofit, and despite having so much Nonprofit, this **product** has the highest (combined) coverage of any Standard Mail **product**, 238.0 percent. And of course ACMA does not mention that even though coverage of this **product** also is pulled down by Nonprofit, it nevertheless exceeds coverage of the Standard Flats **product** by a whopping 156 percent.[17]

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[16] Since the proposed Standard Mail rate increases in Docket No. R2015-4 are essentially at the cap, an increase in the price (and coverage) of Standard Flats would need to be offset by a decrease in the price (and coverage) of one or more other Standard Mail products. Nonprofit using those other products that receive offsetting decreases would benefit.

[17] For the two products discussed here, Letters and HD/Saturation Letters, the "commercial" portion within each has higher coverages than their coverages, respectively, 200.5 and 238.0 percent, since both coverages include Nonprofit. These two products offer a

Fourth, Parcels has the highest share of Nonprofit for any Standard Mail category, 27.1 percent — more than the 22.6 percent in Standard Flats. Despite the high percentage of Nonprofit in Parcels, the Postal Service has proposed a price increase of 9.794 percent for Standard Parcels in Docket No. R2015-4. Docket No. R2015-4, USPS Notice of Market-dominant Price Adjustment, p. 21. A similar percentage increase in the price of Standard Flats would approximately halve this year's unit shortfall of 9.1 cents, but still leave coverage significantly short of 100 percent.[18] There certainly is no good reason why in this year's ACD the Commission should not order a percentage price increase for Standard Flats at or above that proposed for Standard Parcels.[19]

ACMA's Initial Comments ultimately cut through its clutter of its own rearranged categories, as well as various other objections, and finally acknowledge

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clear demonstration that the share of Nonprofit in a Standard Flats product should not be perceived as presenting any bar to a coverage that least equals or even comfortably exceeds 100 percent.

[18] Coverage still would be substantially less than 100 percent **even after allowing for the downward cost adjustments** discussed in the response to ChIR No. 3, Q. 3.

[19] The Postal Service admits that "Standard Mail Flats mailers could sustain a slightly higher price increase." The only reason it did not do so was that "it could not stay within the price cap without also instituting unacceptable price decreases for letters." *Id.*, Postal Service Response to ChIR No. 2, Q. 10. This response omits consideration of any reduction in the price of any other Standard Mail product. In so doing, it illustrates the amateurish pricing framework used by those in the Postal Service who are responsible for pricing decisions. *See* Docket No. ACR2013, Valpak Initial Comments, the Valpak Model for Maximizing Contribution, which offers a comprehensive way to consider pricing tradeoffs for every product within a class of mail. As noted in Valpak's Initial Comments, the Postal Service exhibits no pricing expertise worthy of Commission deference.

even that coverage of **commercial catalogs** within the Standard Flats **product** continued to be far **below 100 percent** in FY 2014:

> **The cost coverage reported for the Commercial component is 90.6%** (down 3.28 points in 2014), and for the Nonprofit component is 53.4% (down 1.55 points in 2014). For both components together, the coverage is 81.6% (down 3.29 points in 2014). These decreases occurred despite CPI and exigency rate increases in January of the year. [*Id.*, p. 20 (emphasis added).]

It is time for the Commission to stop bowing to ACMA's pleas to continue the subsidy to Standard Flats. At the very least, the Standard Flats **product** should have its (combined) coverage brought up to at least 100 percent within no more than two years, and the Commission should so order in this year's ACD.

D. ACMA's Cacophony of Objections to the Reported Costs of Standard Flats Misses the Mark.

ACMA makes yet another broadside attack on the Postal Service costing system in its effort to thwart any Commission action to increase the price and coverage of Standard Flats:

> the costing systems **could be** generating costs that do not relate well to the behavior of operations, meaning they are above marginal.... For the overall increase of 45.7%, **five possible explanations** exist. (1) The costing methods could have changed, but a review of them shows that **this effect was small**. (2) Volume shifting to the FSS could increase these mail processing costs. (3) The actual variabilities could be considerably below 100%, suggesting scale diseconomies and making the costing results invalid.... We know of no analysis of this question. (4) Persistent and still growing amounts of excess capacity could exist in flats processing. (5) The inherent costs of Postal operations could be increasing due to things akin to [exogenous] environmental constraints.... **We know of no such things.** [*Id.*, pp. 9-12 (emphasis added).]

ACMA acknowledges that two of its "possible" explanations — numbers (1) and (5) above — are essentially straw men with little or no effect on costs. ACMA's other three possible explanations are discussed below.

1. Problems with FSS have increased unit cost, but for far different reasons than any volume shifts as hypothesized by ACMA.

The largest source of this year's reported increase in Standard Flats unit cost was mail processing cost. Response to ChIR No. 3, Q. 3. ACMA appropriately identifies FSS as a possible source for the increase in the mail processing portion of unit cost.[20] However, FSS appears to have increased costs for entirely different reasons than suggested by ACMA. The role of FSS as a source of the increase in unit cost for Standard Flats has been probed by Order No. 2313 (January 15, 2015), as well as ChIRs 2, 3, and 4. The responses, including USPS-FY14-45, speak for themselves, and there is no need to repeat them here. The Postal Service had misidentified some IOCS tallies, and has revised downward slightly the increase in unit cost as originally reported. *See* Postal Service Response to ChIR No. 3, Q. 3 (Feb. 5, 2015). However, even as revised, the **unit cost of Standard Flats increased by 5.3 percent** from FY 2013 to FY 2014.

Deployment of FSS began in 2011 and was completed during 2012. Thus all FSS machines had been fully deployed for at least two years by the end of FY 2014. The bottom line, conservatively stated, is that to date FSS has not resulted in reducing the unit cost of

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[20] FSS, the most recent technology for sorting flats, is used to DPS about 20 percent of all flats, but its implementation has been troubled. The AFSM100, which is still used for around 70 percent of all flats, is a mature proven technology, hence an unlikely candidate for unexpected cost increases.

Standard Flats. Despite receiving significant support for FSS deployment from flats mailers over the years,[21] the effect of FSS on costs has been a source of frustration for all flats mailers.

ACMA speculates "[t]he effect of FSS processing likely contributed to the increase in 2013 and to the much larger increase in 2014." ACMA Initial Comments, p. 12. Certainly it would appear that the FSS has not fulfilled its promise to cut costs, and one of the reasons is that there is less flats volume available to sort on these machines than the Postal Service projected.[22]

The Postal Service is striving to increase efficiency of flats processed on FSS. Toward that end, a combination of new requirements and price incentives will have mailers prepare all flats destinating in FSS zones according to FSS schemes. Conceivably, these measures may reduce FSS costs marginally. However, any FSS cost reductions will have limited impact on coverage for the entire Standard Flats **product** because only 20 to 25 percent of all Standard Flats are processed on FSS. The remaining Standard Flats will continue to be processed mostly on AFSM100s, with the balance processed manually. The Commission certainly would have no justification for relying on recent tinkering in the preparation and pricing of FSS mail as an excuse to postpone further a long overdue remedial change in the price of Standard Flats. Only if future cost reductions ever materialize should they be recognized by the Commission.

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[21] http://postcom.org/public/2007/MTAC_FSS_Update.02.21.07.pdf

[22] Indeed, maintaining flats volume to sort on the FSS may be one of the reasons that the Postal Service has kept Standard Flats prices artificially low — even below cost. If Standard Flats were charged an appropriate price, it would no doubt lead to further volume losses, thereby exposing the Postal Service to criticism for its decision to invest heavily in the FSS program. The reasons behind Postal Service pricing decisions are never transparent.

It would be, at the very least, highly imprudent for the Commission to refuse yet again to take any remedial action based on little more than speculation about hypothesized cost reductions that may never materialize.

2. The unit cost of flats may be increasing as volume declines.

ACMA Initial Comments include the following two statements concerning variabilities:

> Mail processing costs are developed consistent with marginal principles and are tailored to be long-run in nature. In the analysis, **their variability is taken to be near 100%,** implying that no fixity exists in the costs and that scale economies are not available. [*Id.*, p. 10 (emphasis added).]
>
> The **actual variabilities could be considerably below 100%, suggesting scale diseconomies** and making the costing results invalid. And note that if the variabilities are below 100%, the question of how the variability percentages change with volume must be faced. We know of no analysis of this question. [*Id.*, p. 12 (emphasis added).]

Together, these two statements represent a classic example of "on the one hand" and "on the other hand." The first of these two comments by ACMA starts by observing that the Commission has long **assumed** that mail processing cost is 100 percent volume variable. That assumption does indeed imply no scale economies and no fixity in costs, as ACMA asserts. The second statement says that (I) the assumption of 100 percent volume variability **could be wrong,** (ii) variabilities **could be less than 100 percent,** and (iii) the assumption is **not known** to have been **analyzed.**

The Commission's assumption of 100 percent volume variability arose in an era when mail processing was much less automated than today. That long-held assumption is questioned by ACMA's second statement and also by the Postal Service's response to ChIR No. 2.

Variability of mail processing cost in an automated environment might be an issue worthy of investigation by the Commission in a discrete docket, but it has no bearing here. The Commission and the Postal Service have spent years developing a costing methodology which they have determined is as accurate as possible, and must be employed in an even-handed way. Efforts to continue to improve that methodology are appropriate, but if every speculative concern about costing were to block the Commission from using those costs to do its job under PAEA, the Commission would need to terminate all ACR reviews. In prior ACD's, the Commission has ruled that ACMA's challenges to postal costs cannot justify underwater pricing. *See, e.g.,* FY 2011 ACD, p. 119 ("Parties alleging that the CRA costing methodology is not reliable must demonstrate flaws underlying the costing methodology or data collection in order to merit consideration. The anecdotal evidence of possible costing anomalies appearing in the results of the CRA cost models for specific types of costs, as presented in this docket, is not sufficient.").

ACMA appears to reference the concept of costs increasing due to volume declines, but then discounts this problem as having caused significant increases in Standard Flats costs:

> some scale economies could have been lost, though one would not expect a long-run marginal cost curve sloping upward toward the vertical axis to account for cost increases of this magnitude. [ACMA Initial Comments, p. 9.]

The Postal Service's response to ChIR No. 2, Q. 8e strongly suggests that the increase in unit cost reflects lower productivity resulting from the decline in flats volume. The AFSM100 has been the workhorse of the flats mail processing fleet of machines (*see* Docket No. ACR2013, Valpak Initial Comments, pp. 69-70). It is a mature, well-functioning technology. However, FSS processing may have hobbled AFSM100 productivity to some extent. The Postal Service explains:

> Several factors account for the observed productivity declines. The cited AFSM100, APBS/SPBS, and APPS operations have all seen significant **declines in workload** over the FY2007-FY2014 period, **reflecting the declining volume trends for flat-shape mail.** …
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> For AFSM100 Incoming Secondary (IS), note that the productivity declined by a relatively modest 3 percent from FY2007 to FY2010 and has remained essentially unchanged from FY2012-FY2014. Thus, the cited productivity decline appears to be a shift corresponding with the implementation of FSS rather than a systematic decline. FSS can affect AFSM100 productivity through two main channels. First, FSS substitutes for AFSM100 IS, and FSS zones typically have favorable volume characteristics (such as high volumes per run) for AFSM100 processing. The **remaining AFSM100 IS runs may be shorter,** and thus the workhours for "allied labor" activities such as setting up and conducting final sweeps of the equipment **may be spread over a smaller volume, reducing productivity.** Second, for FSS zones, parallel AFSM100 IS schemes are maintained to process FSS rejects; these **will tend to be shorter, lower productivity runs** than AFSM100 IS runs for non-FSS zones.
>
> For both SPBS/APBS and APPS, a significant proportion of the operation time is spent in allied labor activities, such as dispatching pallet boxes and wiretainers of bundles from the equipment. Those hours will be spread **over a smaller bundle workload as runs become shorter, tending to reduce productivity.** Likewise, smaller runs on APPS may not proportionally reduce the machine complement over the operational windows.
>
> For FSS … workload peaked in FY2012 and subsequently declined in both FY2013 and FY2014, if less sharply than the other operations. **The implied shorter runtimes from reduced volumes can adversely affect FSS productivity,** since the FSS requires a 12 to 15 minute transition time between schemes, as well as transition time between the first and second sort passes. [Postal Service response to ChIR No. 2, Q. 8e (emphasis added).]

In sum, the across-the-board decline in productivity, along with the corresponding increase in unit cost, is said by the Postal Service to be a result of lower Standard Flats volume owing to the combination of (I) scheme set-up times that are essentially fixed, and (ii) shorter average run times for each scheme. To elaborate briefly, all flats technologies mentioned by the Postal Service (AFSM100, APBS/SPBS, APPS, FSS) either have not changed in any material way or, perhaps, have been improved slightly in 2014, and could be functioning just as well as in the prior year, 2013, but unit costs nevertheless increased. What did change, and what the Postal Service alludes to repeatedly, is the lower Standard Flats volume, which likely resulted in an adverse move back up the cost curve. The year-over-year volume of Standard Flats has declined during each of the last five years.[23] Moreover, for FY 2015, the current year, no known basis exists for projecting an increase in the volume of Standard Flats, along with a lower unit cost which any increase in volume might facilitate. If still lower volumes result in a higher unit cost, that result would be consistent with the Postal Service's explanation, and should not be unexpected.

ACMA's website inadvertently reveals yet another reason why volume reductions can be expected. An ACMA fact sheet explains that those in the 50-and-over age groups comprise the lion's share of catalog purchasers.[24] Younger persons who have grown up with computers have much lower reliance on catalogs, preferring to turn directly to the Internet to locate

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[23] Year-over-year volume of Carrier Route did increase notably in 2013.

[24] https://acma.memberize.net/clubportal/clubdocdisplay.cfm?clubID=2129&docID=16829&priv=0

products. Therefore, ACMA provides yet another possible reason that Standard Flats volumes have declined every year, and may be expected to continue to decline.

3. ACMA's mention of excess capacity as a reason for the high and increasing unit cost of Standard Flats continues to be unsupported and without merit.

ACMA's Initial Comments state that:

> Several factors could play into explaining these [high-cost] outcomes. First, the volume declines could have led to **excess capacity**.... Persistent and still growing amounts of **excess capacity** could exist in flats processing.... Looking at the overall period, however, it **seems likely that costs of excess capacity** are being attributed. [ACMA Initial Comments, p. 9, 12 (emphasis added).]

Excess capacity has become one of ACMA's standard shibboleths. Valpak's Reply Comments filed in the last ACR responded to this same ACMA point concerning the possibility that costs of excess capacity are improperly attributed to Standard Flats. Those earlier Valpak comments are incorporated herein by reference. *See* Docket No. ACR2013, Valpak's Reply Comments, pp. 16-20.

ACMA's discourse this year starts with "could have" and "could exist" and then morphs into "it seems likely." However, ACMA makes no effort to explain whether the excess mail processing capacity to which it alludes takes the form of (I) available but unused time on FSS machines (not too likely), or (ii) unutilized capacity on AFSMs, or (iii) idle labor in those facilities that still sort Standard Flats manually.

Labor constitutes about 80 percent of total Postal Service costs, so presumably ACMA envisions idle labor being charged to Standard Flats. Since the Postal Service has hired thousands of new workers to replace thousands of recent retirees, there is no evidence to support such suggestions that the Postal Service has tenured workers who cannot be furloughed, and ACMA cites to none. A statement that the Postal Service needlessly has hired thousands of new employees whose efforts cannot be utilized and now has excess idle labor capacity is akin to saying that Postal Service operations are indeed quite inefficient. This is a rather serious charge that should not be made lightly, yet ACMA offers no evidence for its charge. ACMA is properly seen to be desperately groping for any reason to discredit the Postal Service's costing system to give the Commission an excuse to avoid taking meaningful remedial action to end the subsidy of commercial catalogs. The Commission has no latitude to base its decisions on such flimsy arguments.

E. Conclusion.

The tenor of the Initial Comments of the American Catalog Mailers Association ("ACMA") reflects that organization's grave concern that the noticeable deterioration in coverage of the Standard Flats product in FY 2014 — a year when unit losses jumped up to **9.1 cents per piece**, and total annual losses increased to **$460 million** — will force the Commission's hand to issue a meaningful remedial order that finally will end the subsidy which has benefitted catalogers by almost **$3.5 billion over the past seven years**. ACMA claims on its website under "Recent Achievements, 2014-15: Catalog Postal Rates" that ACMA:

- Effectively gained an **indefinite stay of execution** after the **PRC's previous finding of noncompliance** of Standard Mail Flats that **would have forced** catalog postal rates higher.[25] [Emphasis added.]

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[25] "ACMA Success," http://www.catalogmailers.org/clubportal/ClubStatic.cfm?clubID=2129&pubmenuoptID=36521.

ACMA tells prospective members exactly what Valpak has told the Commission in prior comments — that the Commission's remedial order has been ineffective. As ACMA calls it: "an indefinite stay of execution." *Id.*

II. Public Representative

A. Standard Flats.

1. Standard Flats — degraded coverage, without hope, without applause.

Since the Postal Service again failed to provide the Commission with a presentation of losses from underwater products over time in its ACR, the PR developed a table containing that information for the past three fiscal years. PR Initial Comments, Table IV-1, p. 26. And, due to the longstanding problem of losses from Standard Flats, the PR presents those losses tracked back to FY 2008 in a separate chart. *See id.*, Chart IV-1, p. 33.

The PR observes that in FY 2014 "for all products that still fail to cover their attributable costs … either cost coverage increased or actual losses decreased" — **"except for Standard Mail Flats**." The PR correctly describes FY 2014 as witnessing a "**degradation** for **Standard mail Flats**." *Id.*, p. 25 (emphasis added).

The PR notes that "in FY 2014, the financial performance of Standard Mail Flats is much less promising" than in FY 2013 — perhaps garnering the award for "Understatement of the Docket." *Id.*, p. 32. But then, the PR more directly described FY 2014 losses as "**break[ing] the hope** for improvement in Standard Mail Flats cost coverage…." Valpak agrees — and asserts that the Commission can no longer delay issuing a strong remedial order based on such "hopes" that have been unfulfilled for years on end.

Valpak also agrees with the PR, who "strongly believes that in order to improve the cost coverage for Standard Mail Flats the Postal Service should continue into the future with a 'special remedy' that provides for above CPI price increases for Standard Mail Flats." *Id.*, p. 33. Regrettably, however, the PR does not suggest any particular remedy. Certainly, much more is needed to strengthen the Commission's current, disappointingly vague "above-CPI" price remedy, which the Postal Service has implemented in the most minimalistic way since Docket No. ACR2010. The PR states that in its comments on the FY 2013 ACR, it "applauded" what it called the "decrease in institutional burden" of Standard Flats. There was no similar PR applause for Standard Flats in FY 2014. *Id.* at 32.

2. Elasticity. The PR believes that the Postal Service's continued failure to comply with Commission directives to provide product elasticities created a "lack of knowledge about elasticity for Standard Mail Flats [that] creates additional problems in setting prices for the product." *Id.*, pp. 33-34. Normally it is true that the more one knows about how a product will respond to a price change, the better one can price the product. However, as to Standard Flats there are two offsetting factors.

First, the Postal Service argued that the Valpak Standard Mail Contribution Optimizing Model (offered in its current form in Docket No. ACR2013) should not be used because reliable product elasticities were unavailable. Docket No. ACR2012, Postal Service Reply Comments, pp. 12-13. The Postal Service reported to the Commission that the product elasticities that it had obtained were not reliable, and again the Commission directed the Postal Service to develop reliable product elasticities. *See* FY 2013 ACD, p. 55. The Postal Service has not yet responded to the

Commission's FY 2013 ACD directive to develop product elasticities. The Commission should now direct the Postal Service to (I) explain fully all efforts it has made to develop such estimates, (ii) share all estimates developed, including an explanation of why those estimates are considered unreliable, and then (iii) devote such additional resources as may be necessary to develop reliable product elasticities. Certainly, the Postal Service's failure to develop individual product elasticities should not be rewarded with continued deference to Postal Service underpricing of Standard Flats.

Second, it is not necessary to have elasticity estimates to improve pricing of underwater products. *See* Valpak Initial Comments, p. IV-15. For the reasons set out in Valpak's Initial Comments, regardless of whether Standard Flats has relatively higher or lower elasticity, the appropriate remedy is raising prices in a meaningful way to reduce and then stop the subsidy being extracted from other mailers. *Id*. The absence of Postal Service elasticity estimates for individual products cannot and should not distract from the fact that Standard Flats are, and have been for many years, out of compliance with 39 U.S.C. § 101(d) and must not hinder Commission development of an appropriate pricing remedy for resolving that noncompliance.

3. Demand-Based Pricing. Lastly, the PR urged use of demand-based pricing to "ensure the greater product contribution to institutional costs, and result in a positive effect from such rate increases on the general public and other mail users in accordance with 39 U.S.C. § 3622(c)(3)." PR Initial Comments, p. 34. Valpak agrees generally, but with the proviso that demand-based pricing should apply only to above-water products. Any product with coverage less than 100 percent should get **an above-average price increase that is sufficient to bring it comfortably above water**, regardless of the product's elasticity. *See* 39 U.S.C. § 101(d).

Of course, there is no reason to believe that the Postal Service actually uses the Postal Service's "joint" elasticity estimates in its current pricing decisions, or would use elasticity estimates for individual products if it had them. Those responsible for Postal Service pricing seem determined to undermine and frustrate any effort to develop a successful business model designed to enhance Postal Service liquidity. Valpak developed its Standard Mail Contribution Maximizing Model in order to facilitate the use of elasticity estimates in developing optimal pricing.

Finally, so long as the Postal Service fails to develop individual product elasticities, it is more difficult for the Commission to scrutinize Postal Service pricing decisions, including compliance with 39 U.S.C. § 3622(c)(3). *See* Valpak Initial Comments, pp. III-16 and n.27, IV-8, and IV-13-16. And since the absence of individual product elasticities allows the Postal Service to continue to object to use of the Valpak model, the Postal Service would appear to have little incentive to comply with Commission directives to develop such product elasticities.

B. Standard Parcels.

The PR discusses underwater Standard Parcels, noting that, due to a transfer of a large portion of Standard Parcels to competitive products, that product now has a higher portion of nonprofit mail. "However," the PR continues, "two years have passed since the date of the transfer, providing a sufficient period of time for the Postal Service" to begin to increase the cost coverage of that product. The PR concludes:

> *the Postal Service should continue taking **serious measures** to improve cost coverage for Standard Mail Parcels, 'by proposing above average price increases in future price adjustments,' as stated in 2014 ACR.* [PR Initial Comments, p. 31 (emphasis added).]

If the PR is urging more aggressive remedial pricing for Standard Parcels than for Standard Flats, no explanation is provided. The Postal Service has noticed a 9.8 percent price increase for Standard Parcels in Docket No. R2015-4. In that docket in response to ChIR No. 2, Q. 10, the Postal Service explained it "determined that a larger price increase for Parcels [than Standard Flats] was necessary at this time" because "[p]arcels has a lower cost coverage" than Standard Flats.[26] The much-too-low coverage on Parcels provides absolutely no reason not to also propose a comparable price increase on Standard Flats, which also has a much-too-low coverage. Most assuredly, both underwater products represent a pricing problem that the Commission should address decisively in this year's ACD. But Standard Flats suffered what might be termed a "**foregone contribution**" of **$460 million** (*i.e.*, a loss of $460 million), while the "foregone contribution" from Standard Parcels was **$34 million**. Primary attention should be paid to the product suffering the biggest loss of much-needed contribution, and that is Standard Flats, not Standard Parcels.

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[26] The Postal Service also explained that it could not increase Standard Flats prices by an amount similar to Standard Parcels and stay within the price cap, "without also instituting **unacceptable price decreases** for letters, which would **likely** result in **revenue losses**." The result the Postal Service asserts losses in **"revenue"** are likely — but not **contribution**. Again, this supposed pricing justification demonstrates that the Postal Service has no capacity to think, or price, like a business. Businesses do not focus on gross revenue — they focus on net contribution. **Businesses that focus on gross revenue and ignore net contribution (profit) go out of business.** Indeed, the Valpak Standard Mail Contribution Maximizing model demonstrates that much higher than above-average increases for both Standard Flats and Standard Parcels would result in **contribution** increases, even if it resulted in a **revenue** decrease. *See* Docket No. ACR2013, Valpak Initial Comments, pp. 33-42.

III. Other Commenters

A. Pitney Bowes

Pitney Bowes' Initial Comments focused on certain differences between two First-Class Mail products:

- First-Class Mail Single-Piece Letters/Cards, and
- First-Class Mail Presort Letters/Cards.

Pitney Bowes notes the existence of a large gap in both cost coverage and unit contribution between these two products every year since 2008;

- the **cost coverage gap** now has grown to **145.4 percentage points** (174.8 percent and 320.2 percent, respectively), and
- the **unit contribution gap** is **5.2 cents** (26.0 cents and 20.8 cents, respectively).

Pitney Bowes contends that the "continuing disparity in unit contribution and cost coverage cannot be justified." PB Initial Comments, p. 2.

The problem in First-Class Mail raised by Pitney Bowes is similar to the problem in Standard Mail under current Postal Service pricing. *See* Valpak Initial Comments, pp. IV-1-8. However, in Standard Mail the problem is even greater for the following reasons:

- Unlike First-Class Mail where the comparison is made between two profitable products, Standard Flats is deeply underwater (as is Standard Parcels).
- The Commission has made prior findings of unlawful rates under 39 U.S.C. § 101(d) with respect to a Standard Mail product — Standard Flats — but there has been no such finding with respect to First-Class Mail.
- In FY 2014, the cost coverage gap between HD/Saturation Letters and Standard Flats increased from 150.9 percentage points to **156.4 percentage points** —

even higher than the difference between the First-Class Mail Single-Piece and Presort products (145.4 percentage points).[27]

- In FY 2014, the difference in unit contribution between the two products complained of in First-Class was **5.2 cents**, while the difference between the unit contribution between HD/Saturation Letters and Standard Flats was a whopping **17.6 cents** in FY 2014 (positive 8.5 cents and negative 9.1 cents, respectively).

Thus, the problem of intra-class disparities that exists within Standard Mail is far more serious than First-Class Mail, constituting a violation of several provisions of Title 39, including 39 U.S.C. § 101(d).

Like Valpak's urging for Standard Mail, Pitney Bowes tries to urge the Postal Service to do what is actually in its own best interest to correct an unjustifiable disparity within First-Class Mail:

> Under the CPI price cap, the overall amount of First-Class Mail revenue is limited, but the Postal Service can use its pricing authority to **increase the contribution** that revenue produces. The Postal Service should rebalance the cost coverage and unit contribution among First-Class Mail products by **lowering prices on more profitable and price sensitive** Presort letters.... Rebalancing the unit contribution among products within First-Class Mail Letters to preserve and encourage the **growth of its most profitable products** would improve the Postal Service's financial position and create a **more equitable price schedule**. [Pitney Bowes Initial Comments, p. 2. (emphasis added).]

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[27] *See* Valpak Initial Comments, p. IV-2, Table IV-1.

Pitney Bowes succinctly summarized the application of rational and lawful pricing principles to First-Class Mail. By using economically rational rates, the Postal Service could increase contribution while operating within the price cap.[28]

Pitney Bowes' comments regarding First-Class Mail help illustrate why the Postal Service's flawed approach to pricing makes it extremely unlikely — almost impossible — that (i) in the near term the Postal Service will generate surplus liquidity anywhere near sufficient for its backlog of investment needs, and (ii) over a longer term the Postal Service will be able to achieve financial self-sufficiency on its own initiative.

The Postal Service has stated publicly that its business model is "broken" and thus it wants Congress to bestow upon it even greater pricing power by diminishing the role of the Commission. However, it is the Postal Service's current pricing polices that have "broken" the Postal Service's business model. It is the Commission's responsibility to order a stop to such abusive and illegal pricing.[29]

B. United Parcel Service

Initial Comments of the United Parcel Service explain the financial realities of capital investments that the Postal Service faces.

> These investments and operational changes entail procurement of billions of dollars. According to Postmaster General Donahoe, "The Postal Service is aiming to more than double its

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28 Indeed, although the Valpak Standard Mail Contribution Maximization Model was designed for Standard Mail, it readily could be modified to apply to First-Class Mail, so as to identify rates which increase, even maximize, the contribution obtainable under a price cap regime.

29 *See also* NPPC Initial Comments, discussed *infra*.

> package-delivery business within a few years," and it "**plans to invest $10 billion over the next four years** for improvements, including buying new vehicles, retrofitting old ones and upgrading package-sorting equipment." This includes investments in a large new fleet of "UPS sized" vehicles designed to accommodate parcels. [UPS Initial Comments, p. 7 (emphasis added) (citation omitted).]

The financial reality is that the Postal Service cannot accumulate $10 billion for investment if it insists on losing over $1 billion each year on underwater products in Standard Mail. Conversely, if the Postal Service priced its products so that they did not lose money, as well as other ways to **increase contribution within the price cap**, it could generate the funds needed to make capital improvements. To illustrate, if the Postal Service just solved the problem of underwater Standard Flats, at current rates of loss, savings from this source alone over a 10 year period would generate approximately $4.6 billion to spend on capital investment.

Indeed, the focus of the UPS comments on the significance of capital expenditures raises the issue of how much money $460 million annually is to the Postal Service. Compare the following needs in the Postal Service's FY 2015 Capital Plan[30] with the $460 million loss on standard Flats in FY 2014.

- $400 million for Vehicles;
- $400 million for CS & Support Equipment;
- $500 million for Facilities; and
- $700 million for Mail Processing Equipment.

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[30] U.S. Postal Service Integrated Financial Plan, FY 2015, p. 6.

Already the Commission has determined that the Postal Service's decision to continue to choose to lose in the range of $460 million annually by underpricing Standard Flats is illegal. When this loss is compared to the Postal Service's capital needs, it is nothing short of **reckless**.

C. National Postal Policy Council

NPPC has been a regular, sophisticated commenter in Commission dockets. NPPC poses excellent questions whether Postal Service pricing "satisfies objective 1 ('maximize incentives to reduce costs and increase efficiency') or objective 5 ('assure adequate revenues')."[31] NPPC Initial Comments, p. 6. And, although NPPC's concerns relate to First-Class Mail, NPPC members appear to share the same frustration with illogical and illegal Postal Service pricing of First-Class Presort Letters and Cards as Valpak has with HD/Saturation Letters:

> In 2011, NPPC commented that the Postal Service seemed to be following a **strategy of extracting the maximum possible revenue** from the diminishing number of First-Class Presort pieces in the mailstream, **rather than** pricing its **most profitable product** in a manner that encourages **volume stability and growth**. See NPPC Comments, Docket No. ACR2010, at 3-4. **Nothing seems to have changed**. [*Id.*, p. 8 (emphasis added).]

Yes, indeed.

Despite these broadly understood business principles, Postal Service pricing continues in its own unbusinesslike way to focus on revenues rather than on net contribution. With several commenters highlighting the irrationality and illegality of continuing to allow

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[31] *See* discussion of factors and objectives in the Appendix to these Reply Comments.

underwater products, it is more clear than ever why Congress entrusted the Commission with the final responsibility to order remedial price changes.

D. Utah Hispanic Chamber of Commerce

In short comments, the Utah Hispanic Chamber of Commerce ("UHCC") brings common business sense to the table.

> Curiously, these rate hikes will apply to its monopoly products, which, in certain cases, are consistently profitable. As an illustration of this point, Total First Class Mail — for which rates will increase 1.949% — has been found to cover 221% of its costs.
>
> Given such high profitability it is highly doubtful that rate increases would be appropriate for such monopoly products. **A more prudent approach for the Postal Service would be for the agency to instead implement more substantial rate increases for the aforementioned products that are losing money, and further, to question the viability of providing these services altogether.** Under the proposed measures and current accounting methods, it is truly difficult to disprove that the Postal Service is leveraging its gains on monopoly services **to sustain non-core service offerings that are not covering their costs.** [Utah Hispanic Chamber of Commerce Initial Comments, pp. 1-2 (emphasis added).]

What? Increase prices for products that are losing money? Questioning whether the Postal Service can afford to continue to offer products that lose large amounts of money every year? Show more restraint on price increases for highly profitable products? The Postal Service doubtless would view such questions by this new postal commenter to be uninformed. However, Valpak's response is: "Three cheers for the UHCC."

E. National Taxpayers Union

NTU's stated concern is with "the financial management of the United States Postal Service and the impact of USPS' business practices on the economy as a whole." NTU Initial Comments, p. 1. And along those lines, NTU has raised the persistent problem of underwater products:

> which are generating insufficient revenue in relation to expenses by a significant margin. Such **an inclination to persist in allocating funds for revenue-negative products year after year reflects a deficiency in operational judgment**.
>
> **Products that do not cover their costs** must prompt the Postal Service to either establish a **more rational pricing structure** or **investigate the merits and ability of providing them** in the future. [*Id.* (emphasis added).]

Valpak concurs.

Respectfully submitted,

/s/

William J. Olson
Jeremiah L. Morgan
John S. Miles
WILLIAM J. OLSON, P.C.
370 Maple Avenue West, Suite 4
Vienna, Virginia 22180-5615
(703) 356-5070

Counsel for:
Valpak Direct Marketing Systems, Inc. and
Valpak Dealers' Association, Inc.

APPENDIX: STANDARD MAIL FLATS IS NOT IN COMPLIANCE WITH THE OBJECTIVES AND FACTORS OF SECTION 3622

39 U.S.C. § 3622 describes the "modern system for regulating rates" required by PAEA, as being based on certain Objectives, Factors, and Requirements. This Appendix reviews Standard Flats compliance with statutory Objectives and Factors, and supplements points made in Valpak's Initial and Reply Comments.

1. "(b) Objectives. — Such system shall be designed to achieve the following objectives, each of which shall be applied in conjunction[32] with the others:"

"(1) To maximize incentives to reduce costs and increase efficiency."
By allowing below-cost pricing, the Postal Service has continued to provide incentives for Standard Flats mailers to utilize high-cost, inefficient service, in violation of this objective.

"(2) To create predictability and stability in rates."
Postal Service pricing of Standard Flats provides predictably underwater pricing, but this is not what Congress meant. Money losing products are inherently unsustainable. Certainly there can be no long-term rate stability as Postal Service finances deteriorate. Due to several factors, including the liquidity crisis caused by underwater, subsidized products including Standard Flats, the Postal Service successfully argued for and implemented an exigent increase on January 26, 2014. The exigent increase caused unpredictability and instability for all mailers.

"(3) To maintain high quality service standards established under section 3691."
The failure to cover costs contributes to the financial deficit that is forcing Postal Service initiatives designed to reduce services and service standards for all mailers as well as recipients.

"(4) To allow the Postal Service pricing flexibility."
As the Commission found in the FY 2010 ACD, the Postal Service failed to use its pricing flexibility to prevent the subsidization of Standard Flats. Pricing flexibility does not exist for itself, but must be "applied in conjunction with the other" objectives and only within the bounds of lawful rates.

"(5) To assure adequate revenues, including retained earnings, to maintain financial stability."
This objective is violated, as the Postal Service has lost almost $3.5 billion in Standard Flats since FY 2008.

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[32] Elevating any one of these objectives to disregard noncompliance with other, multiple objectives, would violate the basic requirement that they be "applied in conjunction."

"(6) To reduce the administrative burden and increase the transparency of the ratemaking process."

Developing an appropriate pricing remedy for Standard Flats to bring them into full cost coverage certainly does not conflict with this objective. Indeed, it would finally bring some transparency into Postal Service pricing, especially since the Postal Service has never provided an adequate explanation of why it arbitrarily favors catalogs over other mailers, such as coupon mailers.

"(7) To enhance mail security and deter terrorism."

Not particularly relevant.

"(8) To establish and maintain a just and reasonable schedule for rates and classifications...."

A just and reasonable schedule does not permit a cost coverage of less than 100 percent. As the D.C. Circuit stated, "the persistent losses incurred by Standard Flats amount[] to **a subsidy of Flats at the expense of other Standard Mail products (and their customers)**...." U.S. Postal Service v. PRC at 1106 (emphasis added). This is unjust and unreasonable, and also violates 39 U.S.C. § 101(d).

"(9) To allocate the total institutional costs of the Postal Service appropriately between market-dominant and competitive products."

Not particularly relevant.

2. "(c) Factors. — In establishing or revising such system, the Postal Regulatory Commission shall take into account —"

"(1) the value of the mail service actually provided each class or type of mail service to both the sender and the recipient, including but not limited to the collection, mode of transportation, and priority of delivery."

Standard Flats, like all Standard Mail, is advertising mail. It should not be subsidized, especially by other types of advertisers.

"(2) the requirement that each class of mail or type of mail service bear the direct and indirect postal costs attributable to each class or type of mail service through reliably identified causal relationships plus that portion of all other costs of the Postal Service reasonably assignable to such class or type."

The Commission ordered in the FY 2010 ACD that Standard Flats be required to cover its own costs. Such a requirement is a good start, but fails to take into consideration the requirement that each type of mail service bear a "portion of all other costs of the Postal Service." *See also* 39 U.S.C. § 101(d) ("Postal rates shall be established to apportion the costs of all postal operations to all users of the mail on a fair and equitable basis.").

"(3) the effect of rate increases upon the general public, business mail users, and enterprises in the private sector of the economy engaged in the delivery of mail matter other than letters."

Without product elasticities, the Postal Service pricing operates in the dark with respect to this factor.

"(4) the available alternative means of sending and receiving letters and other mail matter at reasonable costs."
The content of Standard Flats mail has alternative means of delivery, and most catalogs now are available through electronic media.

"(5) the degree of preparation of mail for delivery into the postal system performed by the mailer and its effect upon reducing costs to the Postal Service."
Not particularly relevant. Cost reductions have proven inadequate to bring Standard Flats to 100 percent cost coverage.

"(6) simplicity of structure for the entire schedule and simple, identifiable relationships between the rates or fees charged the various classes of mail for postal services."
Pricing products below costs sends irrational price signals to mailers.

"(7) the importance of pricing flexibility to encourage increased mail volume and operational efficiency."
The term "pricing flexibility" is employed by the Postal Service as if it were the second most important element of the "modern system for regulating rates" in PAEA, right behind the price cap in section 3622(d). Pricing flexibility does not exist to be exercised in an arbitrary manner. According to this factor in PAEA, pricing flexibility may only be exercised within the context of lawful rates, and has importance for two reasons: to encourage (I) increased mail volume, and (ii) operational efficiency.

"(8) the relative value to the people of the kinds of mail matter entered into the postal system and the desirability and justification for special classifications and services of mail."
Not particularly relevant. Standard Flats is advertising matter with neither more nor less value than any other advertising matter.

"(9) the importance of providing classifications with extremely high degrees of reliability and speed of delivery and of providing those that do not require high degrees of reliability and speed of delivery."
Not particularly relevant.

"(10) the desirability of special classifications...."
Not particularly relevant.

"(11) the educational, cultural, scientific, and informational value to the recipient of mail matter."
Not particularly relevant.

"(12) the need for the Postal Service to increase its efficiency and reduce its costs, including infrastructure costs, to help maintain high quality, affordable postal services."
Standard Flats costs cannot be reduced sufficiently for that product to break even. Pricing a product to cover its costs certainly does not conflict with this factor. Pricing products below cost sends improper pricing signals to mailers to enter mail that cannot be handled as efficiently as other mail.

"(13) the value to the Postal Service and postal users of promoting intelligent mail and of secure, sender-identified mail."
Not particularly relevant.

"(14) the policies of this title as well as such other factors as the Commission determines appropriate."

The Commission already has determined that Standard Flats was not in compliance with 39 U.S.C. § 101(d) in FY 2010. This finding was upheld by the U.S. Court of Appeals for the District of Columbia. Thus, Flats is not in compliance with factor (14), incorporating 39 U.S.C. § 101(d) as the Commission determines appropriate.